



National Audit Office

Report

by the Comptroller
and Auditor General

Department of Health

Sustainability and financial performance of acute hospital trusts

Key facts

-£471m

net deficit of NHS bodies (NHS England, clinical commissioning groups, NHS trusts and NHS foundation trusts) overall in 2014-15

-£843m

net deficit of NHS trusts and NHS foundation trusts in 2014-15

61%

of acute trusts (94 out of 155) reported a deficit at the end of 2014-15

115 out of 240 (48%)

NHS trusts and NHS foundation trusts in deficit in 2014-15

-£958 million

net deficit of acute trusts in 2014-15 (those NHS trusts and NHS foundation trusts that provide acute healthcare services)

26

acute trusts in 2014-15 with deficits that made up more than 5% of their income

83%

of planned efficiencies were achieved by acute trusts in 2014-15

£1.8 billion

additional funding given to NHS trusts and NHS foundation trusts in financial difficulty as a cash injection, loan or other financial support in 2014-15

181 out of 239 (76%)

NHS trusts and NHS foundation trusts reporting deficits in the first 6 months of 2015-16

Summary

1 In 2014-15, the Department of Health (the Department) allocated £98 billion of its £111 billion budget to its largest arm's-length body, NHS England, to plan and pay for NHS services. The 211 clinical commissioning groups spent the greatest share of this, largely buying healthcare from 90 NHS trusts and 150 NHS foundation trusts. The Department spent the remainder of its £111 billion budget on the work of its other arm's-length bodies, special health authorities, funding for public health, and its own functions.

2 There has been significant change in the NHS since the introduction of the Health and Social Care Act 2012. These changes have come at a time of increased financial pressures in government arising from austerity. Health is an area of public spending that the government has protected in recent years compared with most other areas of government spending. However, finances have become increasingly tight with health funding rising at a historically low rate of 1.8% in real terms between 2010-11 and 2014-15. The Department is ultimately responsible for securing value for money for this funding. In 2014-15, it came close to exceeding its £111 billion revenue expenditure budget authorised by Parliament, underspending by just £1.2 million or 0.001%.

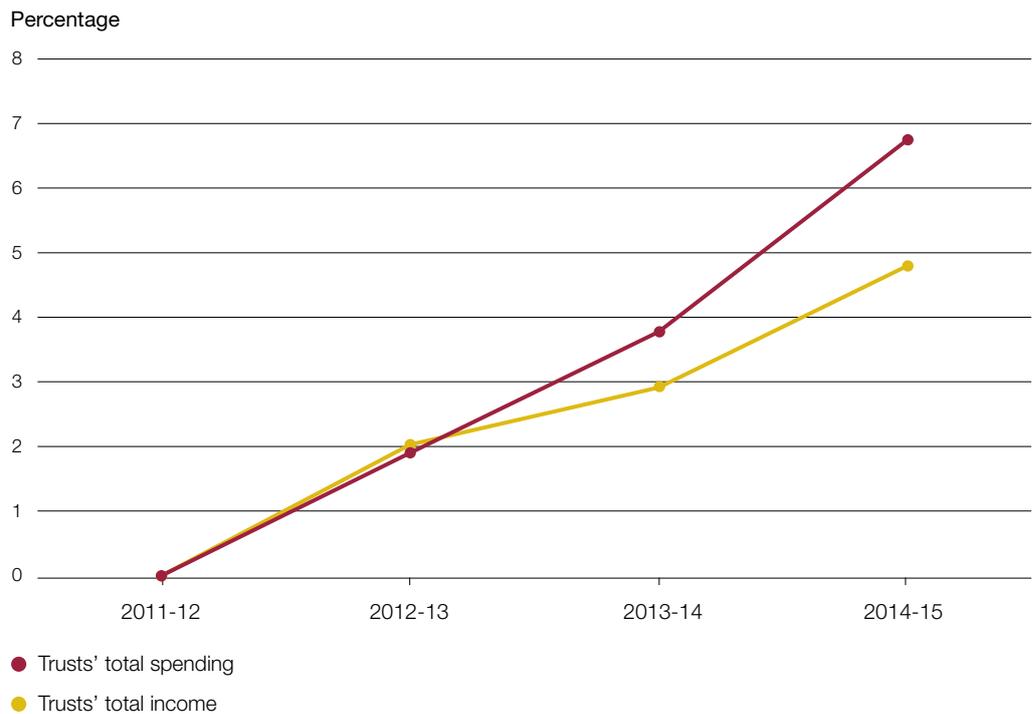
3 The NHS *Five Year Forward View*, published in October 2014, set out proposed changes to the provision of healthcare services. NHS England expects that the NHS will need to continue to adapt in response to increasing patient demand, new treatments and technologies and funding constraints. The *Five Year Forward View* estimated there will be a £30 billion gap between resources and patient needs by 2020-21. It estimated that if the NHS had £8 billion more funding, the gap between resources and patient needs would be £22 billion by 2020-21. In November 2015, the government committed to increasing funding for the NHS by £8.4 billion by 2020, with £3.8 billion of this given to the NHS in 2016-17.

Our report

4 NHS trusts and NHS foundation trusts achieve financial sustainability when they are able to successfully manage activity, quality and financial pressures within the income they receive. In recent years, the growth in spending by NHS trusts and NHS foundation trusts has outpaced growth in their income (**Figure 1** overleaf). This indicates that trusts are increasingly unable to keep their spending within budget.

Figure 1

Cumulative increase in NHS trusts' and NHS foundation trusts' income and spending since 2011-12



Notes

- 1 NHS trusts' and NHS foundation trusts' spending and income figures are adjusted to remove the effects of impairments, transfers of functions from, or, to other health bodies, and charitable funds.
- 2 Figures are adjusted for inflation using the GDP deflator, as used by HM Treasury in setting departments' budgets.

Source: National Audit Office analysis of Department of Health annual accounts, NHS Trust Development Authority and Monitor data

5 We have reported three times on financial sustainability in the NHS, most recently in November 2014.¹ The subsequent Committee of Public Accounts report, published in February 2015, concluded that the financial health of NHS bodies had worsened in the previous two financial years. The Committee was concerned that the savings required across the NHS will be difficult to achieve solely by continuing with the same approach used in recent years.

¹ Comptroller and Auditor General, *The financial sustainability of NHS bodies*, Session 2014-15, HC 722, National Audit Office, November 2014. Available at: www.nao.org.uk/report/financial-sustainability-nhs-bodies-2/

6 In this fourth report on financial sustainability in the NHS:

- We report the summarised financial position of NHS England, clinical commissioning groups, and the NHS trusts and NHS foundation trusts providing ambulance, acute, community, mental health and learning disability services. We take a closer look at the two-thirds of NHS trusts and NHS foundation trusts that are acute trusts providing acute healthcare services such as accident and emergency (A&E) services, inpatient and outpatient, and in some cases specialist, and, or, community care (Part One).
- We examine the factors affecting the financial sustainability of acute trusts (Part Two). Acute trusts received 78% of NHS trusts' and NHS foundation trusts' income in 2014-15. Due to its size, understanding the financial position of the acute trust sector is important for assessing risks to overall NHS financial sustainability.
- We consider the approaches taken by the Department, NHS England, Monitor and the NHS Trust Development Authority (NHS TDA) to support trusts to achieve financial sustainability (Part Three). In the medium- to long-term, the health service must be financially stable to be able to deliver high quality services for patients.

7 We set out our audit approach in Appendix One and evidence base in Appendix Two. Technical notes explaining how we have used financial data are in Appendix Three, including an explanation of how we have calculated the financial position of NHS trusts and NHS foundation trusts. The report does not look at primary care, social care, public health or similar services.

Key findings

The financial performance of NHS bodies

8 In 2014-15, NHS commissioners, NHS trusts and NHS foundation trusts together overspent for the first time, reporting an overall deficit of £471 million.

In 2014-15, the surplus reported by commissioners was not enough to compensate for the deficit reported by NHS trusts and NHS foundation trusts together. The £471 million deficit was made up of:

- NHS England spending £30,808 million of the £30,998 million available for its national functions and centrally commissioned services, achieving an underspend of £190 million;
- clinical commissioning groups together spending £66,852 million of the £67,034 million available for locally commissioned services, achieving an underspend of £182 million; and
- NHS trusts and NHS foundation trusts reporting a combined deficit of £843 million against their total income of £74,539 million (paragraph 1.3 and Figure 7).

9 The financial position of NHS bodies overall has continued to decline since 2012-13. The £471 million deficit reported by commissioners, NHS trusts and NHS foundation trusts together represents a worsening financial position from the £722 million surplus achieved in 2013-14 and the £2.1 billion surplus in 2012-13 (paragraph 1.3).

Performance of NHS trusts and NHS foundation trusts

10 The deterioration in the financial position of NHS trusts and NHS foundation trusts has been severe and worse than expected. Their £843 million net deficit in 2014-15 reflects a sharp decline from trusts' £91 million deficit reported in 2013-14, and trusts' £592 million surplus reported in 2012-13. Trusts' deficit on 31 March 2015 was significantly greater than the forecast deficit (£512 million) set on 30 June 2014 (paragraphs 1.5 and 1.7, Figure 3).

11 The number of NHS trusts and NHS foundation trusts reporting a deficit rose by 80% between 2013-14 and 2014-15. Overall, 115 trusts were in deficit in 2014-15 compared with 64 in 2013-14 and 25 in 2012-13. The number of trusts with a surplus fell to 125 in 2014-15 from 181 in 2013-14 (paragraph 1.6 and Figure 3).

12 The average earnings before interest, tax, depreciation and amortisation (EBITDA) margin for existing NHS foundation trusts fell below the threshold used by Monitor to assess long-term financial sustainability. It is the government's intention that all NHS trusts will become NHS foundation trusts that are financially robust. Monitor assesses that an EBITDA margin of 5% or greater demonstrates financial strength. It uses this measure to test whether an NHS trust is ready to be authorised as an NHS foundation trust. At the end of 2014-15, the average EBITDA margin for NHS foundation trusts was 3.7% and 99 NHS foundation trusts (66%) were below the 5% threshold (paragraph 1.11).

13 Monitor and the NHS TDA expect the number of trusts under strain to rise. The net deficit of NHS trusts and NHS foundation trusts together is forecast to rise further in 2015-16, to £2.2 billion by 31 March 2016. The number of trusts forecasting a deficit by the end of 2015-16 is 156. But halfway through the financial year at 30 September 2015, 181 trusts reported deficits. This is a 57% increase on the number of trusts that reported a deficit 6 months earlier on 31 March 2015 (paragraph 1.8).

Pressures on the financial sustainability of acute trusts

14 Acute trusts are under financial stress, with 6 in 10 reporting a deficit

in 2014-15. Acute trusts were more likely to report a deficit in 2014-15 (61%) than ambulance trusts (20%), community trusts (16%) or mental health and learning disability trusts (29%). Acute trusts together reported a net deficit of £958 million (equivalent to 1.6% of their total income). This was 3 times the size of acute trusts' deficit in 2013-14 (£306 million or 0.5% of total income). A significant number of acute trusts face severe financial difficulties, with 26 reporting deficits that made up more than 5% of their income in 2014-15. Of these 26 acute trusts, 14 had deficits greater than £20 million, and 20 are planning to be in deficit for a third consecutive year in 2015-16 (paragraphs 1.15, 1.16 and 1.19, and Figure 7).

15 Some common features of acute trusts' income and spending help to explain their performance. Acute trusts' financial performance is affected by factors within the local area, and a combination of income and spending pressures, and their success in managing these. Our analysis shows:

- The growth in acute trusts' spending outpaced the growth in their income between 2013-14 and 2014-15, with their total spending increasing by 5% and their income rising by 4% over this period.
- Acute trusts that received a greater share of their income from providing healthcare, including work funded by the national tariff, were more likely to be in deficit than acute trusts with proportionately more non-healthcare income.
- Acute trusts' spending on non-permanent staff as a share of their total income increased by 24% between 2012-13 and 2014-15. Acute trusts have increasingly incurred the premium costs associated with using non-permanent staff, such as agency staff. Monitor has reported that a rise in spending on agency staff has been exacerbated by the difficulties of recruiting staff into permanent posts and by new requirements for safe staffing levels following the Keogh and Francis reviews.
- Acute trusts with private finance initiatives (PFI) spent an average of £28 million on interest, service and capital payments for their PFI commitments in 2014-15. PFI schemes provide new facilities and can lead to quality improvements. However, high levels of spending on PFI commitments can put at risk the financial sustainability of some trusts. For 11 acute trusts, spending on PFI commitments made up more than 10% of their yearly spending (paragraphs 2.5, 2.7 and 2.14 to 2.15).

16 Acute trusts made significantly fewer efficiencies in 2014-15 than in 2013-14.

They reported efficiencies of £2.2 billion in 2014-15, compared with £2.3 billion in 2013-14. Acute trusts achieved efficiencies by making cost savings and generating new income. Overall, acute trusts achieved 83% of their planned efficiencies in 2014-15. But if all trusts had achieved their planned efficiencies, the deficit for acute trusts together would have more than halved and 75 acute trusts rather than 93 would have ended the year in deficit (paragraphs 2.19 and 2.21).

17 Acute trusts' have increasingly planned to make efficiencies that are unsustainable.

Around 62% of the efficiencies reported by acute trusts in 2014-15 (£1.35 billion) were recurrent (permanent) cost savings. Trusts achieve recurrent savings by, for example, reducing the length of hospital stays. In 2014-15, trusts made £322 million of non-recurrent (one-off) cost savings, up from £317 million in 2013-14. These included savings from measures such as stopping recruitment. Where savings are one-off, the NHS will have to find more savings in future to replace them. Guidance by Monitor and the Audit Commission on delivering sustainable cost improvement programmes advised that trusts' schemes to generate more income were not sustainable in the long-term. However, trusts' planned efficiencies through such income generation schemes had risen to £507 million in 2014-15. This was up from £374 million in 2013-14 and £330 million in 2012-13 (paragraphs 2.19 and 2.20).

Managing financial distress

18 NHS trusts and NHS foundation trusts under financial stress continue to rely on cash support from the Department.

The Department provides additional funding so that trusts in difficulty have the cash they need to pay creditors and staff and to fund building works considered essential to support patient services. In 2014-15, NHS trusts and NHS foundation trusts received £1.8 billion of additional financial support as a result of being in financial difficulty. More trusts received revenue-based support in 2014-15 than in 2013-14 (30 NHS trusts and 19 NHS foundation trusts, up from 21 and 10 respectively). Fifteen NHS trusts in financial distress received cash support (£176 million in total) that improved their reported financial position. Without this, the deficit for NHS trusts and NHS foundation trusts together would have been £1 billion (paragraphs 3.2 to 3.4).

19 The response by the Department, Monitor and the NHS TDA to cut trusts' deficits might come too late to improve the 2015-16 financial position.

In June 2015, the Department announced limits on some elements of trust spending in response to the worsening financial position of NHS trusts and NHS foundation trusts. However, some of these limits were not enforced by the Department, Monitor and the NHS TDA until halfway through the year. This reduces the scope of the spending limits to improve finances in 2015-16. Furthermore, it is not clear if the 'stretch targets' identified by the NHS TDA and Monitor for all NHS trusts and some NHS foundation trusts will reduce trusts' forecast deficit for 2015-16 as intended (paragraphs 3.6, 3.7, 3.12 and Figure 17).

20 Despite recent efforts to work together, interventions from the Department and arm's-length bodies risk creating perceived or actual competing priorities for trusts. Trusts must manage central decisions on funding and spending, alongside maintaining operational standards and meeting guidelines. One area where advice to trusts could have created actual or perceived conflicts between meeting quality and safety standards, and improving finances, is on safe staffing. The Department's interventions to reduce trusts' spending on agency nursing staff came at a time when acute trusts were finding they needed to recruit more nurses to meet safe staffing guidelines. It is important that the Department and its arm's-length bodies work together to provide timely and clear messages to trusts (paragraphs 3.15 to 3.17).

21 The revisions and restatements to trusts' 2015-16 financial plans undermine effective financial planning. Following a review of NHS trusts and NHS foundation trusts draft plans, Monitor and the NHS TDA intended to review trusts' final plans in April 2015. But this was delayed after the rejection of the 2015-16 national tariff by providers and subsequent negotiations with NHS England and Monitor. The introduction of stretch targets in July and August by the NHS TDA and Monitor meant that all NHS trusts and 57 NHS foundation trusts had to review their plans and restate their end of year forecast. NHS trusts' financial plans were resubmitted to the NHS TDA in September 2015, 6 months into the financial year. NHS foundation trusts' financial plans were still under review by Monitor in October 2015, 7 months into the financial year. This unsettled planning period might make it difficult for NHS trusts, NHS foundation trusts, the NHS TDA, and Monitor to set and agree targets, measure progress and ultimately manage resources effectively (paragraphs 3.8 to 3.12).

Achieving long-term financial sustainability

22 The Department and its arm's-length bodies are taking steps to learn how trusts could reduce costs but the wider use of this learning is not clear. Monitor has looked at how NHS foundation trusts can find savings from planned healthcare services. In his review of hospital productivity and efficiency, Lord Carter of Coles examined a sample of 22 trusts and estimated that the NHS could save up to £5 billion each year to 2020 by making better use of staff, using medicines more effectively and getting better value from the products it buys. The productivity measures developed in this work are based on trusts' reference costs from 2014-15. These were the average unit costs to the NHS of providing healthcare. However, there were concerns about the accuracy of the reference cost data in previous years. Concerns remain over the extent to which the cost savings identified apply to all trusts, and how the learning should be used by trusts in their financial planning (paragraph 3.20).

23 The Department and its arm's-length bodies agree there will be a £22 billion gap between resources and patient needs by 2020-21 but it is not clear how the NHS will close this gap. NHS England has estimated that demand and efficiency gains of 2%–3% a year are needed to make savings of £22 billion. However, the NHS has achieved a much lower rate of efficiencies in recent years. Expected financial savings from the *Five Year Forward View* will not help the immediate financial position of trusts, as estimates suggest these will not be realised until nearer the end of the five years. The Department told us that its Finance and Efficiency board is developing a plan that will be informed by funding decisions made by government in November 2015, and will allow the NHS to close the gap between resources and patient needs. But it is not yet clear how and when most of the £22 billion of savings will be made, or the contribution that individual organisations and sectors are expected to make. We would expect the Department and its arm's-length bodies to develop and implement a coherent plan that shows how the gap between resources and patient needs will be closed by all parts of the NHS. This plan should be aligned with resources and requirements for patient care, and should be communicated so that trusts can plan for financial sustainability (paragraphs 3.19 and 3.21).

24 The redesigned models of healthcare are new and untested, and making savings through these will be challenging. The NHS new models of care aim to breakdown the boundaries between primary, hospital and community care, and integrate services around the needs of the patient. NHS England has made some assumptions about the savings it expects from the new models of care and when these will be realised. But achieving savings through redesigned healthcare is not easy. Acute trusts have fixed costs and, in many cases, large-scale changes requiring investment are needed for them to make savings. This suggests that closing the efficiency gap is ambitious. Furthermore, the *Five Year Forward View* makes the case for sustained social care services and a radical upgrade in public health and prevention as a way to reduce demand for acute services. But the cut in public health funding could make it even more challenging for local health economies to deliver efficiency improvements (paragraphs 3.22 to 3.27).

Conclusion on value for money

25 We said in our November 2014 report on NHS financial sustainability that the trend of NHS trusts' and NHS foundation trusts' declining financial performance was not sustainable.² At that time, trusts overall, including acute trusts, were in a better financial position. But since then, acute trusts' financial performance has deteriorated sharply. And their financial position is forecast to worsen. With financial problems endemic, we repeat our view that these trends are not sustainable.

2 See footnote 1.

26 The Department, NHS England, Monitor and the NHS TDA have responded to trusts' financial distress with measures to help improve financial performance. But trusts' financial management has been undermined by a turbulent planning period and the multiple interventions by the Department, Monitor and the NHS TDA that seek to control trusts' spending. Effective oversight by the Department and its arm's-length bodies will become harder if the number of trusts in financial distress rises further.

27 Running a deficit seems to be becoming normal practice for acute trusts. And there is a risk that poor financial performance is not taken as seriously as poor healthcare provision. This weakens the effectiveness of market-style mechanisms designed to improve hospital productivity and efficiency. The government's commitment to increase funding for the NHS could be a significant step towards acute trusts achieving financial balance. But this depends on how the funding is used and the impact of wider changes to healthcare services. The Department, NHS England, Monitor and the NHS TDA need to take a more holistic, coordinated approach to tackling trusts' persistent financial problems and move beyond quick fixes to cut trusts' spending. Until there is a clear pathway for trusts to get back to financial stability, we cannot be confident that value for money, defined as financial and service sustainability, will be achieved.

Recommendations

- a The Department, NHS England, Monitor and the NHS Trust Development Authority (NHS TDA) should work together to improve the trust planning process and their oversight of financial risk.** Unexpected delays in the 2015-16 planning process meant that financial plans were still being reviewed and restated more than halfway into the financial year. As a result, these plans were of limited use in monitoring risk to trusts' finances.
- Monitor and the NHS TDA should work together to ensure that NHS trusts and NHS foundation trusts have financial plans in place at the start of the financial year.
 - NHS trusts, NHS foundation trusts and commissioners should plan finances together to take account of the needs of the local health economy.³
 - NHS England, Monitor and the NHS TDA should strengthen processes for testing and aligning the assumptions of commissioners and trusts.
 - The Department, NHS England, Monitor and the NHS TDA should improve financial risk management by going beyond one-year planning time frames.

³ A local health economy includes all local NHS organisations such as GP practices, and voluntary and independent sector bodies involved in the commissioning, development and provision of health services for particular population groups.

- b When designing measures to control costs, the Department should consider how these measures will be implemented successfully.** The Department has introduced a number of controls on trusts' spending, but it is unclear how much impact they will have within trusts. The controls need to be introduced at the right time so they can be coordinated with trusts' financial planning. Monitor and the NHS TDA should share best practice to highlight how interventions may be put into practice.
- c The Department, NHS England, Monitor and the NHS TDA should put in place a clear plan for improving financial sustainability.** It will take time to achieve savings from changes under the *Five Year Forward View*. Interventions to reduce trusts' deficits create a constantly changing environment that could lead to ineffective financial management. The Department and its arm's-length bodies should help create a period of financial stability to enable trusts and local health economies to make change while maintaining operational standards.
- d The Department must move ambitiously and more thoroughly to set out savings goals to secure financial sustainability.** In order to close the expected funding gap of £22 billion, it needs the NHS to make efficiency savings to 2020-21. The Department must set out how much it expects acute trusts to contribute towards this goal. It must work with Monitor, the NHS TDA and NHS England to set out clear plans for trusts to achieve this. Monitor and the NHS TDA should look in more detail at the ambition and achievability of trusts' cost improvement plans.
- e Price and tariff setters (NHS England and Monitor) should move faster to ensure that payment systems support change and promote financial sustainability.** The different ways in which acute hospital trusts generate income affects their overall financial performance. Payment systems do not always support financial sustainability. This led to an increase in the amount of extra financial support in 2014-15. The Department, NHS England, Monitor and the NHS TDA should develop and share a clear pathway for stability which reduces the need for reactive financial support.